Microbusiness, Macro-impact

Capitalizing on Potential

By Valerie Plummer, Executive Director, Oregon Microenterprise Network (OMEN)

Jenny Richardson was a sculptor in New York City who came down with a chronic illness after the 9/11 attacks. In and out of hospitals and bankrupt, she made her way to Portland, OR. With the help of a $7,000 Mercy Corps Northwest loan, she opened Jennie Greene Floral Designs in a trendy Portland neighborhood. "I had an idea, but I wasn't eligible for a (bank) loan," says Richardson, who is meeting her loan payments as agreed. This Mother's Day – one of the biggest holidays for flower merchants – Jenny celebrated her business's one-year anniversary. She's learned many lessons during her first year, and is hopeful that her second year in business will be one with strong sales and many opportunities for bringing her artistic flower designs to the wider community.

Roots and Evolution of an Industry

In America, the fruits of prosperity are shared unevenly. According to recent statistics quoted by the Aspen Institute, approximately 37 million people in the U.S. live in poverty, and those at the bottom 60 percent in terms of income own less than five percent of the nation's wealth, while wages for the working poor have remained relatively stagnant. In addition, an estimated 22 million people are "unbanked," making saving money and building assets a struggle.[1] Policy makers and practitioners have struggled with how to address these trends and how to mitigate their negative impact on people's financial well-being. Microenterprise and self-employment have emerged as important strategies in the effort to improve the economic well-being of low-income families.

A microenterprise is generally defined as a business with five or fewer employees with capitalization needs under $35,000. Typically, these microenterprises run into difficulties accessing conventional financing due to being economically disadvantaged or not meeting lending criteria. The microenterprise industry that exists in the U.S. today – an industry of over 500 programs serving up to a quarter million people per year – has roots in the international microcredit movement. In the 1970s and earlier, the Grameen Bank in Bangladesh began to provide very small loans ($10-$50) to women to purchase such things as materials for weaving and livestock for food production, which could then be used to generate income for their families. These loans were highly successful in developing countries due to the lack of access to capital in local villages, and the positive peer pressure that resulted from "peer lending" models in which borrowers were accountable to fellow entrepreneurs in their tight-knit communities.

During the 1980s and 1990s, organizations in both the U.S. and abroad experimented with a variety of program and service models that built on this idea of sparking economic self-sufficiency though the provision of microloans. The resulting microenterprise field now encompasses a wide range of organizations, from women's economic development organizations that see microenterprise as a response to the limited employment options for women, to community development corporations that view microenterprise as a complement to community revitalization strategies, to

A Drop in the Bucket: Reaching Scale

Box 2.1

An estimated 10 million microentrepreneurs could benefit from the financing and business development services that microenterprise programs provide, according to a recent study published by the Aspen Institute.[1] Given that some entrepreneurs may not want or need services, and that there are other providers in the marketplace, it is unreasonable to assume that programs should be serving this entire market. However, even if one were to estimate that the field should achieve market penetration of 10 to 20 percent – or one to two million entrepreneurs – the field is currently only reaching between 7.5 and 17 percent of even that share, according to the study's authors. This mismatch between the estimated size of the potential market and the current scale is due to several factors, including the scarcity of funding necessary to expand services, and the geographically-focused or target market-focused nature of programs for whom "scaling up" is not of major concern.

community action agencies which have identified self-employment as an option for people with limited opportunities in the labor force. And while the industry is still young and many organizations are small, it is estimated that as of the end of 2002, $98.5 million was outstanding in microenterprise loans, which represent loans made to nearly 14,000 microentrepreneurs.[2] Many more clients, an estimated 150,000-170,000 in 2000, receive assistance in the form of training and technical assistance, (See Box 2.1, "A Drop in the Bucket").

Products and Services Provided by Microenterprise Development Organizations

Business management training, counseling, business plan development and microloans are essential to help many microenterprises start, expand and prosper. While microenterprise development programs differ in their organizational missions, target populations and program designs, a majority of practitioners help entrepreneurs assess and develop: 1) business readiness and feasibility of business concept; 2) personal readiness; and 3) entrepreneurial skills. Services typically include assistance in identifying the business target market and competition, developing a pricing strategy and sales technique, and guidance that addresses a broad range of practical business issues facing small business owners.

Services may be provided by stand-alone microenterprise development organizations (MDOs), or microenterprise programs within community development corporations (CDCs), Community Development Financial Institutions (CDFIs), or Small Business Development Centers (SBDCs). These service providers all reach different segments of the entrepreneur "market," but do need to effectively work together to bring an entrepreneur from the early concept and start-up phase through the stabilization and growth phase of his or her business.

Microenterprise development programs generally focus on underserved populations who have had difficulty accessing business development services or credit through traditional institutions. At the national level, microenterprise program clients are predominately women (60 percent), low- or moderate-income (60 percent), and ethnic or racial minorities (50 percent). A significant proportion come from very low-income situations, with about 30 percent falling at or below the poverty line, and 11 percent receiving welfare assistance.[3]

Historically, many of these potential entrepreneurs have had loan applications rejected for a variety of reasons, including inadequate equity, lack of a credit (or poor credit) history, failing to meet the bank's underwriting guidelines, as well as racial or gender discrimination. One of the biggest barriers is the loan size–often it is too small to be of interest to a mainstream bank. Regarding the challenge of accessing conventional sources of capital, one aspiring business owner remarked, "You know, a lot of good ideas die in the parking lot of banks." She said, "I knew I was a good baker. I knew I could open a bakery. I knew I could employ people. But I didn't have the collateral, and the amount of money that I wanted was below the lending limit of the bank."

Microenterprise programs aim toward working around some of these barriers to accessing capital, all the while emphasizing training and technical assistance. And while small business ownership is not for everyone–personal commitment and internal motivation are essential for self-employment–developing and running a business can be beneficial for a portion of would-be entrepreneurs. Microenterprise may be a particularly strong option for those living in areas where wage jobs are very scarce, for those with disabilities for whom regular wage employment is a challenge, and for those who may be able to best meet their child-care needs by working from home. Examples from rural Oregon include a married couple who worked in a plant nursery for several years before opening their own specialty nursery, a single mom who opened her own home-based child care facility, and an entrepreneur with a disability who developed and created a blanket designed specially for those in wheelchairs.

Macro-impact

Box 2.2

Microenterprise development can generate benefits on both individual and community levels. Self-employment allows people in low wage jobs to supplement their income at a lesser cost than public assistance[1] and it offers a variety of groups the flexibility to balance work and family. In rural areas, self-employment has become a central means for many to cope with structural unemployment caused by mill and plant closings. And in urban areas where corporate downsizing and a lack of living-wage employment opportunities in distressed neighborhoods have affected communities, microenterprise programs are often able to reach entrepreneurs with increased efficiency and breadth of services. Communities with successful microenterprises can benefit not only from increased availability of new jobs, but also from increased local availability of a diversity of goods and services and a reduction in business loan delinquency and default. This can generate improved commercial districts with vibrant retail stores and restaurants, increased tax revenues, and reduced public assistance costs.

In many states, those involved in community economic development have recognized that a homegrown, collaborative approach can be more successful than the old economic paradigm of searching for big manufacturing plants or employers that will bring in hundreds of new jobs. Coupling microenterprise development services with other workforce development, community revitalization and economic literacy initiatives is a way to amplify program effectiveness and a means to contribute to improved local economic development.

The Outcomes of Microenterprises in the U.S

Jenny Richardson's floral design shop in Portland, OR was made possible through a microloan from Mercy Corps Northwest.

One critique of microenterprise is that small business is also risky business, and that very few businesses see their first anniversary, let alone thrive for the long-term and create a stable source of income for the business owner and/or others. But with the proper technical assistance, microbusinesses can do very well. Survival rates of microbusinesses compare favorably to the general population of small businesses. A study conducted by the Self Employment Learning Project (SELP) of the Aspen Institute showed 49 percent of micro businesses surviving after five years, with average revenues increasing 27 percent and profits doubling in that period. Nearly three-fourths of the microentrepreneurs increased their household income over five years, and more than half – 53% – of poor entrepreneurs moved over the poverty line.[4] Compared with working one (or several) jobs at minimum wage, microenterprise appears to be a viable strategy that can complement other options available to the working poor who are striving toward economic self-sufficiency.

Program and service costs of microenterprise development are in line with those of other job creation strategies designed to help low-income individuals improve their incomes. In addition, there are multiplier effects that stem from self-employment strategies. While many microentrepreneurs will

Effective Practices in Action

Box 2.3

Testing Microenterprise as an Income-Generation Strategy in Portland

In 2004, Portland's Bureau of Housing and Economic Development (BHCD) launched the Economic Opportunity Initiative, which currently invests in 30 citywide projects that work with very low-income Portlanders. All Initiative projects share a common goal to raise individual participant's incomes and assets by a minimum of 25 percent within three years.

At one year after project launch, the following results have been reported:

- Thirty small projects based on best practices serve 994 low-income people;
- Nine Microenterprise Development projects currently serve 256 very small businesses;
- Twenty-one workforce projects are linked to employers and provide training, internships, employment and retention for 738 low-income residents;
- After one year, existing businesses are achieving a 50.4% increase in revenue. The average annual revenue increase for existing businesses ($18,738) far exceeds the cost of the program ($8,000 per participant over three years, with the majority spent in the first year);
- The Initiative is leveraging new health care, legal services and technology support for participants.

not grow their businesses to employ more than themselves, the average microenterprise creates 1.5 jobs per business.[5] And an analysis of the U.S. microenterprise industry prepared for the International Labor Organization (ILO) estimates that return on investment in microenterprise development ranges from $2.06 to $2.72 for every dollar invested.[6]

Engaging Financial Institutions

The financial support of the microenterprise development field is complex. It receives public funding from various departments of the federal government – including the SBA, Treasury Department (through the CDFI Fund), Department of Labor, HUD (through the Community Development Block Grant, or CDBG, Program), USDA and the Department of Health and Human Services – and a variety of departments within state and local governments, as well as private funding from foundations and corporations.

In addition, banks play a pivotal role in microenterprise development, though most, due to fixed transaction costs that make small loans of $500 to $35,000 unprofitable, have not found it financially feasible to provide direct financing to many of the customers of microenterprise development organizations. Instead, banks have generally welcomed opportunities to partner with programs that assume part of the cost of serving microenterprise clients (See Box 2.4, "Innovations in Oregon").

This solution has been effective because microenterprise practitioners act as intermediaries between entrepreneurs and mainstream banks. The arrangements banks have made with microenterprise development programs range from grants (usually $5,000 to $50,000), forgivable loans, and low-interest loans and lines of credit (i.e. the organization receives a loan from the bank to capitalize a loan fund, which the organization then uses to lend to entrepreneurs), to actually making loans to program clients. In the latter case, banks may either take the full risk or the microenterprise organization may assume part of the risk by providing partial loan guarantees, or by making an agreement that a specific percentage of the total loan portfolio will be covered by a loan-loss reserve fund. The Community Reinvestment Act (CRA) has provided major incentives (as well as the threat of sanctions) for bank participation in serving the low-income clientele who are reached by microenterprise development programs.

Other benefits can stream from successful partnerships between financial institutions and microenterprise programs. The training and technical assistance that microenterprise practitioners provide can be a form of risk reduction, and clients build positive repayment histories and greater financial skills. After a microloan is repaid, entrepreneurs can be referred to financial institutions for larger business loans. In addition, communities targeted by microenterprise intermediaries are often in geographies that are outside a bank's "footprint" or in areas where alternative, and often predatory, financial service providers are prevalent. By partnering with microenterprise intermediaries, mainstream financial institutions have the potential to reach new customers and target products and services in new ways.

Increasing Opportunity, Realizing Potential

Owning a business has always been part of the "American Dream," and microenterprise is a critical option for a portion of the working poor. Microenterprise should be

Innovations in Oregon

Box 2.4

Banks Supporting Capital Access for Microenterprise

The Oregon Microenterprise Network (OMEN) is launching a statewide revolving loan fund that will provide capital access to Oregon communities that do not have loan programs for microenterprise. Many community development organizations in Oregon, especially in rural areas, provide considerable guidance, skill development, and technical assistance for start-up and emerging microenterprises but are limited by lack of access to financing for their clients. By partnering with these local practitioners, OMEN will be able to provide loans to those entrepreneurs unable to access conventional sources of financing.

The statewide loan fund will provide first-time loans up to $10,000 and growth loans up to $25,000 for those that successfully pay their original loans. The fund will be centrally administered by OMEN which will be in continuing communication with the local partners to ensure their client's success. The local partner will be required to provide technical assistance to the borrower throughout the life of the loan. OMEN will employ an experienced loan officer and administrator to provide the essential expertise.

OMEN is partnering with several Oregon financial institutions to provide the necessary funds and grants—approximately $500,000 in total—to support administration of the fund. Funds will come in the form of equity-equivalent (EQ2) investments. In addition to meeting their CRA goals, participating banks see the benefit of public awareness of their community involvement and the potential of future banking customers. As entrepreneurs pay off their loans through the Oregon statewide loan fund, they will in turn become stronger candidates for larger loans as their businesses prosper.

integrated into mainstream employment systems so that self-employment can become a more widely feasible option to help people exit poverty and contribute to their local economies. Achieving this goal will require commitment from legislative bodies, government agencies, funders, and microenterprise programs, all of which will need to collaborate to make major changes in policies, program designs, operating procedures, and outcome tracking and documentation. (See Box 2.5, "Strengthening the Industry"). Such integration should, in the long term, result in stable, mainstream funding for microenterprise development services. As funders and practitioners together build a culture focused on accountability, program performance and return on investment, the field can realize the potential presented by microenterprise development as a viable means to further open wealth and ownership opportunities to individuals and communities long excluded from the mainstream economy.

What is OMEN?

Oregon Microenterprise Network (OMEN) is a statewide network of approximately 45 microenterprise programs and supports providing business training, technical assistance, microloans and other services to low-income and disadvantaged entrepreneurs. OMEN's mission is to increase opportunities for low-income entrepreneurs and communities by building the capacity of Oregon's microenterprise organizations. OMEN accomplishes this through: 1) Providing access to funding for microenterprise programs, 2) Advocacy efforts on a federal, state and local level, 3) Access to capacity-building services through the OMEN Asset Building VISTA Corps, 4) Training and technical assistance for microenterprise service providers, and 5) Facilitation of community efforts that support microenterprise development. Visit us at www.oregon-microbiz.org.

Strengthening the Industry

Box 2.5

Aside from traditional financial support and grantmaking, there are three important ways for funders and financial institutions to help increase the strength of the microenterprise industry:

1. Get to know your local microenterprise development practitioner

A national listing can be found online at www.fieldus.org/Publications/Directory.asp. There are many ways for banks to partner at the neighborhood/branch level, as well as at the state and national level, beyond simply providing funding to practitioners. Also, get to know your state's SMA, or State Microenterprise Association. The majority of states have an SMA, whose sole purpose is to increase the capacity and performance of the microenterprise practitioners. A directory of SMAs can be found at AEO's website, www.microenterpriseworks.org.

2. Invest in building the capacity of microenterprise practitioners to measure and improve performance

To understand the impact of their work and track outcomes, practitioners need to know who they serve (demographics like gender, race and income), how many clients they serve and with what services (training, consulting, microloans), at what rate of success (completed business plans, increased business revenues), and at what cost. Indicators may include data such as business survival rates, changes in business revenue and household income, rates of job creation, changes in public expenditures such as reduction in TANF payments and food stamps, as well as non-economic indicators. These may include personal empowerment due to increased self-esteem and newly developed financial management skills, and community impacts such as increased community involvement and increased creation of mutual support networks among entrepreneurs. The Microenterprise Fund for Innovation, Effectiveness, Learning and Dissemination (FIELD) recommends that "donors can invest in management information systems and other capacities that help their grantees measure and improve performance, and recognize that these investments are required on an ongoing basis. They also can support the further development and expansion of national systems and tools for measuring performance, and capacity-building resources designed to help more institutions come into compliance with national standards."[1]

3. Reward performance through grant-making

FIELD recommends that "donors should expect grantees to participate in industry-wide efforts to measure and improve performance. Funders also should make explicit that grantees must maintain the discipline of working toward higher scale, effectiveness, efficiency and cost recovery as they work to achieve good business and client outcomes. This will involve requiring grantees to report on critical performance measures, as well as structuring grant awards to support and reward progress toward achieving greater internal efficiency and effectiveness, increasing the scale of operations, and producing better outcomes."[2]

Endnotes

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Box 2.1

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Box 2.2

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